DEPARTMENT OF STATE REVENUE
SUPPLEMENTAL LETTER OF FINDINGS: 97-0583SLOF; 98-0355SLOF
Indiana Sales and Use Tax
For the Tax Periods 1991 through 1996

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ISSUES

I. Processing Exemption – Sales/Use Tax.

Authority: IC 6-2.5-2-1; IC 6-2.5-3-2; IC 6-2.5-5-1 et seq.; IC 6-2.5-5-3(b); Indianapolis Fruit Co. v. Department of State Revenue, 691 N.E.2d 1379 (Ind. Tax Ct. 1998); 45 IAC 2.2-5-10(d).

Taxpayer maintains that particular items of in-store equipment – deli prep counter, salad bar prep table, deli slicer, balloon wrap system, cardboard baler – qualify for the processing exemption.

II. Work-in-Process – Handling and Storage Equipment – Sales/Use Tax.

Authority: IC 6-2.5-5-3; Indianapolis Fruit Co. v. Department of State Revenue, 691 N.E.2d 1379, 1385 (Ind. Tax Ct. 1998); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); 45 IAC 2.2-5-8; 45 IAC 2.2-5-8(e)(1); 45 IAC 2.2-5-8(f)(3); 45 IAC 2.2-5-8(f)(4).

Taxpayer argues that material handling equipment employed at its specialty foods division is used to transport work-in-process within the division. As such, the division's material handling equipment is not subject to sales or use tax. In addition, taxpayer asserts that certain items of its in-store equipment – deli cases, salad bars, self-serve bakery cases, floral cases, and lobster tanks – are used to store "work-in-process" and are similarly entitled to the exemption.

III. Refrigeration Equipment – Sales/Use Tax.

Authority: 45 IAC 2.2-5-10; 45 IAC 2.2-5-10(k).

Taxpayer argues that it is entitled to an additional 17 percent credit for certain refrigeration equipment because that refrigeration equipment is associated with its processing and manufacturing activities. In addition, taxpayer argues that it is entitled to a credit for tax previously paid on Freon-recovery equipment.

IV. Labels and Packaging Materials – Sales/Use Tax.

Authority: 45 IAC 2.2-5-15; 45 IAC 2.2-5-16.

Taxpayer maintains that labels used in its pharmacy department and labels used during its in-store manufacturing activities are not subject to sales or use tax.

V. 1991 Refund Claims – Sales/Use Tax.

Authority: IC 6-8.1-9-1.

Taxpayer argues that it is entitled to request additional credits/refunds for taxes incorrectly paid during 1991.

STATEMENT OF FACTS

Taxpayer is a major grocery store chain with, at the time of the audits, over 1,100 retail outlets. In addition, taxpayer operates 25 manufacturing and food processing facilities.

Over the course of two audits, taxpayer's records for 1991 through 1996 were examined. Three of taxpayer's retail store divisions, two dairies, one bakery, one distribution center, and one specialty foods division fell within the purview of the two audits.

The review of taxpayer's transactions resulted in proposed additional assessments of Indiana sales and use tax. Taxpayer protested those additional assessments, an administrative hearing was held, and a Letter of Findings was prepared and published. However, the original Letter of Findings did not address all of the "refund items" which the taxpayer had originally brought to the Department's attention. Accordingly, the Department determined that taxpayer was entitled to a rehearing. However, in the letter granting taxpayer's request for a rehearing, "the scope of the rehearing [was] limited to a review of those issues – included within the original protest – which were not addressed within the original Letter of Findings." In granting the rehearing, the Department gave no indication that the conclusions contained within the original Letter of Findings were erroneous or that those conclusions would be revisited.

DISCUSSION

I. Processing Exemption – Sales/Use Tax.

Indiana imposes a sales tax on retail transactions. IC 6-2.5-2-1. The state also imposes a complementary use tax on tangible personal property that is stored, used, or consumed within the state. IC 6-2.5-3-2. For both of these taxes, certain exemptions are available. IC 6-2.5-5-1 et seq. Taxpayer invokes the equipment exemption found at IC 6-2.5-5-3(b), which reads as follows:

> Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in

> the direct production, manufacture, fabrication, assembly, extraction, processing, refining, or finishing of other tangible personal property.

Taxpayer maintains that its master scales are entitled to this exemption because the "master scales are used to weigh and label work in process items prior to being placed in the items final package."

As pointed out within the original Letter of Findings, "Without production there can be no exemption." Indianapolis Fruit Co. v. Department of State Revenue, 691 N.E.2d 1379, 1385 (Ind. Tax Ct. 1998). The original Letter of Findings came to the conclusion that taxpayer "performs a modicum of processing activities within its in-store bakery and meat departments. Conversely, work performed within taxpayer's cheese, deli, and produce departments cannot be characterized as the processing of tangible personal property." The original Letter of Findings concluded that the activities within the cheese, deli, floral, and produce departments represented the performance of services ancillary to taxpayer's retail sale of groceries. This Supplemental Letter of Findings finds no reason to challenge that original conclusion.

Accordingly, to the extent that taxpayer's master scales and parts are employed *within* the production process occurring in its in-store bakery and meat departments, the master scales and parts are entitled to exempt treatment.

Taxpayer argues that its deli prep counter, salad bar prep table, deli slicer, balloon wrap system, and cardboard bailer are entitled to the exemption because these items of equipment are found within its integrated production process. In support of that assertion, taxpayer cites to 45 IAC 2.2-5-10(d), which reads, in relevant part, as follows: "'Direct Use' begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the processing or refining has altered the item to its completed form, including packaging, if required."

Taxpayer errs in its conclusions concerning the deli prep counter, salad bar prep table, and deli slicer. As noted within the original Letter of Findings, no "production" of tangible personal property occurs within the taxpayer's cheese, deli, and produce departments.

Taxpayer describes its balloon wrap system as follows: "The system combines various materials such as balloons, toys and ribbons and produces gift items sold in the stores." Taxpayer is not entitled to an exemption for the balloon wrap system because there is no indication that the device is in any way involved in the "production" of tangible personal property. Based upon taxpayer's description, the use of the device more closely resembles the services provided within taxpayer's cheese, deli, and produce departments.

Taxpayer maintains that its cardboard bailer is entitled to the exemption. The bailer is used to process empty cardboard boxes into baled and tied units, which are then sold to a recycle processor. Taxpayer is entitled to claim the exemption for its cardboard bailer because, under at IC 6-2.5-5-3(b), the device is directly used in the "processing" of "tangible personal property" which is sold in a subsequent retail transaction. The device acts directly upon an unmarketable

raw material – empty cardboard boxes – transforming that waste material into a form which then can be sold to its recycle processor.

FINDING

As to taxpayer's master scales, the associated master scale parts, and the cardboard bailer, taxpayer's protest is sustained. The remainder of taxpayer's protest is respectfully denied.

II. Work-in-Process – Handling and Storage Equipment – Sales/Use Tax.

Taxpayer operates a specialty foods division. This division produces various deli salads and food dips in bulk. Taxpayer maintains that the material handling equipment used to transport work in process within the plant and between the plant and the individual retail stores is entitled to the exemption afforded under 45 IAC 2.2-5-8. The regulation, in relevant part, states that "Transportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process." IAC 2.2-5-8(f)(3) *See also* IC 6-2.5-5-3.

Taxpayer believes that its status is similar to that of the automobile manufacturer in General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991) *aff'd* 599 N.E.2d 588 (Ind. 1992). In General Motors, the automobile manufacturer shipped component automobile parts to its plants and – as taxpayer here has done – claimed an exemption for the purchase of items employed in the interdivisional transfer of those components parts. The court held that the automobile manufacturer's packing materials were part of the integral process whereby the manufacturer produced its finished product. Therefore, the automobile manufacturer's packing materials were exempt under IC 6-2.5-5-3. The court reached that decision after finding the automobile manufacturer's widely separated production facilities formed a cohesive, singular production unit in which the claimant's "manufacture of finished marketable automobiles [was] accomplished by one continuous integrated production process within which the transport of parts from component plants to assembly plants [was] an essential and integral part." General Motors, 578 N.E.2d at 404.

Taxpayer has failed to establish that the equipment, for which taxpayer now seeks the exemption, is used to transport partially processed salads and food dips within the confines of its specialty foods division. One could postulate a scenario in which an item of equipment is used to move partially manufactured food dip from one location within the specialty foods division to another. However, such is not the case here. There is nothing to indicate that the equipment is used "*within* the production process." 45 IAC 2.2-5-8(f)(3) (*Emphasis added*).

Additionally, taxpayer maintains that – similar to the automobile manufacturer in General Motors – it is entitled to an exemption for the equipment used to transport food products between the specialty foods division and its individual retail outlets. However, the automobile manufacturer was entitled to the exemption because its equipment was used to move partially automobile parts *within* a continuous, integrated production process even though that production process took place at a series of geographically distinct locations. Unlike the automobile manufacturer, it is apparent that the taxpayer's processing of its salads and food dips is complete

once those products leave the specialty food division. There is nothing to indicate that the salads and food dips undergo further processing or production once they leave the specialty food division's doorway. As stipulated within the regulation itself, "Transportation equipment used to transport work-in process, semi-finished, or finished goods between plants is taxable, if the plants are not part of the same integrated production process." 45 IAC 2.2-5-8(f)(4)

Taxpayer maintains that its deli cases, salad bars, self-serve bakery cases, floral cases, and lobster tanks are entitled to the temporary store exemption set out in 45 IAC 2.2-5-8(e)(1). The regulation states that "[t]angible personal property used in or for the purpose of storing work-in-process or semi-finished goods is not subject to tax if the work-in-process or semi-finished goods are ultimately completely produced for resale and in fact resold."

The deli cases, salad bars, and floral cases do not qualify for the exemption because there is nothing to indicate that manufacturing or processing occurs within the respective departments wherein this equipment is located. As previously stated, in the absence of a finding that the taxpayer is producing or processing tangible personal property, there can be no "work-in-progress" and the related equipment will not qualify for the exemption. Indianapolis Fruit, 691 N.E.2d 1384.

Even though it has been determined that a "modicum" of manufacturing activities take place within taxpayer's in-store bakery and meat departments, the lobster tank and the self-serve bakery cases do not qualify for exempt status because these items stand outside whatever processing or production activities occur within the two departments. Rather than temporarily holding "work-in-process or semi-finished goods," these items are used to display products for which production and processing has been completed and which are ready to be selected by the ultimate consumer.

FINDING

Taxpayer's protest is respectfully denied.

III. Refrigeration Equipment – Sales/Use Tax.

The audit found that 12 percent of taxpayer's refrigeration equipment was used to store work-in-process. Accordingly the 12 percent of the refrigeration equipment – used in taxpayer's meat, seafood, bakery, and commissary departments – was classified as "exempt" pursuant to 45 IAC 2.2-5-10.

Taxpayer requests a further exemption on the ground that an additional 17 percent of its refrigeration equipment is used to store work-in-process. According to taxpayer, 17 percent of its refrigeration equipment is attributable to its deli, cheese, produce, and floral departments.

Taxpayer is not entitled to the additional exemption because, as previously stated, there is no processing or refining within those four departments. As noted in 45 IAC 2.2-5-10(k), "A processed or refined end product . . . must be substantially different from the component parts."

There is no indication that the products produced within taxpayer's deli, cheese, produce, or floral departments are "substantially different from the component parts."

In addition, taxpayer requests an exemption for Freon recovery equipment installed within its in-store refrigeration equipment. Taxpayer believes that this equipment is entitled to the exemption because it is associated with its in-store "manufacturing" activities. Consistent with the conclusions of the audit and the original Letter of Findings, taxpayer's Freon recovery equipment is exempt to the extent that the equipment is specifically associated with taxpayer's in-store meat, seafood, bakery, and commissary departments.

FINDING

Taxpayer's protest is denied in part and sustained in part.

IV. Labels and Packaging Materials – Sales/Use Tax.

Taxpayer argues that certain of its packaging labels are entitled to exempt status under 45 IAC 2.2-5-15 and 45 IAC 2.2-5-16. Taxpayer has provided nothing to indicate that the issue was not fully addressed within the original Letter of Findings or that the conclusions contained within that document were in any way erroneous.

FINDING

To the extent that taxpayer's protest is at variance with the original Letter of Findings, taxpayer's protest is respectfully denied.

V. 1991 Refund Claims – Sales/Use Tax.

Taxpayer argues that it was entitled to a further re-examination of its 1991 records to determine whether it overpaid taxes. The audit disagreed, because "the normal statute of limitations had expired on [tax year] 1991." Consistent with that conclusion, the audit determined that "no additional credit items discovered by the taxpayer for 1991 will be considered during this investigation, and if the review of the facts indicate additional use tax was due in excess of the amounts timely claimed, no additional assessment can be made for this year."

The time limitation for filing a refund claim is found at IC 6-8.1-9-1, which states in relevant part:

> If a person has paid more tax than the person determines is legally due for a particular taxable period, the person may file a claim for a refund with the department. Except as provided in subsections (f) and (g), in order to obtain the refund, the person must file the claim with the department within three (3) years after the date of the following:
>
> (1) The due date of the return.
>
> (2) The date of the payment.

It is not disputed that taxpayer's original 1991 refund claim was timely submitted. However, by the time that the audit began examining that claim, the time for making additional 1991 refund claims – or for the Department to make additional assessments – had expired. During the audit examination, certain of taxpayer's refund claims were offset and certain claims were denied. Thereafter, in August of 2000, taxpayer submitted *additional* credit items for the audit's consideration because taxpayer viewed the initial offsets and denied claims as if they were audit payments which triggered anew the running of IC 6-8.1-9-1.

Taxpayer maintains that it is not seeking an additional refund but "believes these additional items should be considered in computing net offsets to amounts claimed." Taxpayer makes a distinction without a difference. Taxpayer filed its secondary claims in August of 2000 well beyond the time limitation contained with IC 6-8.1-9-1. The initial consideration of taxpayer's 1991 refund claim did not toll the running of the three-year limitations period specified under IC 6-8.1-9-1. Plainly stated, taxpayer is seeking a refund of overpaid 1991 taxes long after the allowable period for doing so had expired. This it may not do because, as correctly pointed out to the taxpayer, "there is no provision for legally extending this time limit."

FINDING

Taxpayer's protest is respectfully denied.

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